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# Guide for establishing and maintaining a system of quality control for a CPA firm's accounting and auditing practice : recommendations;

American Institute of Certified Public Accountants

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***Guide for  
Establishing and  
Maintaining  
a System of  
Quality Control  
for a CPA Firm's  
Accounting and  
Auditing Practice***

*Recommendations of the  
AICPA Joint Task Force on  
Quality Control Standards*

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***A M E R I C A N***

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***I N S T I T U T E   O F***

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***A C C O U N T A N T S***

## NOTICE TO READERS

This Guide presents recommendations of the AICPA Joint Task Force on Quality Control Standards (task force) on the application of Statements on Quality Control Standards. This Guide has not been approved, disapproved, or otherwise acted on by the Auditing Standards Board, the membership, or the governing body of the American Institute of Certified Public Accountants. Therefore, the contents of the Guide, including the recommendations, are not authoritative.

The suggested policies and procedures presented herein are illustrative only and firms are encouraged to consider these examples in designing and maintaining a quality control system that is appropriate for their accounting and auditing practice. A firm's policies and procedures should be sufficient for it to obtain reasonable assurance of complying with the requirements of Statements on Quality Control Standards, which, in turn, should be sufficient for a firm to obtain reasonable assurance of complying with professional standards. In considering an appropriate quality control system for its accounting and auditing practice, a firm should be aware that although some of the illustrative procedures are not explicitly required by professional standards, they present the views of the task force regarding an appropriate quality control system. The views of the task force are provided through illustrative examples of four hypothetical firms and their systems of quality control.

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# Chapter 1

## Overview of Statements on Quality Control Standards

1.01. Statement on Quality Control Standards (SQCS) No. 2, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice* (AICPA, *Professional Standards*, vol. 2, QC sec. 20), provides that a CPA firm shall have a system of quality control for its accounting and auditing practice and describes the elements of quality control and other matters essential to the effective implementation and maintenance of the system. A system of quality control is broadly defined as a process to provide the firm with reasonable assurance that its personnel comply with applicable professional standards and the firm's standards of quality.

1.02. SQCS No. 2, paragraph 4, provides that the nature, extent, and formality of a firm's quality control policies and procedures depend on a number of factors, such as its size, the number of its offices, the degree of authority allowed its personnel and its offices, the knowledge and experience of its personnel, the nature and complexity of its practice, and appropriate cost-benefit considerations.

1.03. A firm should establish a system of quality control that includes policies and procedures related to each of the five elements of quality control identified in SQCS No. 2, which are as follows:

- a. *Independence, Integrity, and Objectivity*
- b. *Personnel Management*
- c. *Acceptance and Continuance of Clients and Engagements*
- d. *Engagement Performance*
- e. *Monitoring*

1.04. The monitoring element of quality control is further described in SQCS No. 3, *Monitoring a CPA Firm's Accounting and Auditing Practice* (AICPA, *Professional Standards*, vol. 2, QC sec. 30).



1.05. The elements of quality control are interrelated. For example, the maintenance of *Integrity*, *Objectivity*, and, where required, *Independence* requires a continuing assessment of client relationships that affect policies and procedures for the acceptance and continuance of clients and engagements. Similarly, the element of *Personnel Management* encompasses criteria for professional development, hiring, advancement, and assignment of the firm's personnel to engagements, which affect policies and procedures developed to meet the objectives of the quality control element of *Engagement Performance*. Similarly, policies and procedures for the quality control element of *Monitoring* evaluate whether the policies and procedures that are required by the firm related to each of the other four elements of quality control are suitably designed and are being effectively applied.

1.06. When a firm merges, acquires, sells or otherwise changes a portion of its practice, the surviving firm should evaluate and, as necessary, revise, implement, and maintain firm-wide quality control policies and procedures appropriate in light of the changed circumstances.

## **Independence, Integrity, and Objectivity**

1.07. The objective of the *Independence, Integrity, and Objectivity* element of a system of quality control is to provide the firm with reasonable assurance that personnel maintain independence (in fact and in appearance) in all required circumstances, perform all professional responsibilities with integrity, and maintain objectivity in discharging professional responsibilities.

1.08. This objective ordinarily would be satisfied by establishing and maintaining policies such as—

- Requiring that personnel adhere to applicable independence, integrity, and objectivity requirements. Regulations, interpretations, and rulings of the AICPA, state CPA societies, state boards of accountancy, state statutes, the Securities and Exchange Commission (SEC), and other regulatory agencies should be considered where applicable.
- Communicating policies and procedures relating to independence, integrity, and objectivity to personnel.
- Confirming the independence of another firm engaged to perform part (or parts) of an engagement, or when acting as principal auditor.

## **Personnel Management**

1.09. The objective of the *Personnel Management* element of a system of quality control is to provide the firm with reasonable assurance that all personnel have the proficiency to perform their assigned responsibilities. Attributes or qualities that enhance the proficiency of personnel who perform, supervise, or review work include integrity, objectivity, intelligence, judgment, competence, experience, and motivation.

1.10. This objective ordinarily would be satisfied by establishing and maintaining policies such as—

- Hiring personnel who possess the appropriate characteristics to enable them to perform competently.
- Assigning personnel who have the degree of technical training and proficiency required in the circumstances. In making assignments, the nature and extent of supervision to be provided should be considered. Generally, the more qualified and experienced the personnel assigned to a particular engagement, the less direct supervision is needed. Conversely, the less qualified and less experienced the personnel assigned, the more direct supervision generally is needed.
- Having personnel participate in general and industry-specific continuing professional education and professional development activities that enable them to fulfill responsibilities assigned, and satisfy applicable continuing professional education requirements of the AICPA and regulatory agencies.
- Selecting for advancement only those who have the qualifications necessary for fulfillment of the responsibilities they will be called on to assume.

## **Acceptance and Continuance of Clients and Engagements**

1.11. The objective of the *Acceptance and Continuance of Clients and Engagements* element of a system of quality control is to establish criteria for deciding whether to accept or continue a client relationship and whether to perform a specific engagement for that client. Such policies and procedures should provide the firm with reasonable assurance that (a) the likelihood of association with a client whose management

lacks integrity is minimized, (b) the firm undertakes only those engagements that can be completed with professional competence, (c) the risks associated with providing professional services in particular circumstances are appropriately considered, and (d) an understanding is reached with the client regarding the services to be performed.

1.12. These objectives ordinarily would be satisfied, both with respect to the initial period for which the firm is performing its service and for subsequent periods, by establishing and maintaining policies such as—

- Evaluating factors that have a bearing on management's integrity.
- Evaluating whether the engagement the firm will perform can be completed with professional competence and, accordingly, undertaking only those engagements that can be completed with professional competence; and appropriately considering the risk associated with providing professional services in particular circumstances.
- Obtaining an understanding with the client regarding the services to be performed.

## Engagement Performance

1.13. The objective of the *Engagement Performance* element of a system of quality control is to provide the firm with reasonable assurance that the work performed by engagement personnel meets the applicable professional standards, regulatory requirements, and the firm's standards of quality. Policies and procedures for engagement performance encompass all phases of the design and execution of the engagement. To the extent appropriate and as required by applicable professional standards, these policies and procedures should cover planning, performing, supervising, reviewing, documenting, and communicating the results of each engagement. Policies and procedures should also provide that personnel refer to authoritative literature or other sources and consult, on a timely basis, with individuals within or outside the firm, when appropriate.

1.14. This objective ordinarily would be satisfied by establishing and maintaining policies such as—

- Requiring that all engagements be planned to meet professional, regulatory, and the firm's requirements.

- Requiring that the work performed and the reports and other communications issued meet professional, regulatory, and the firm's requirements.
- Identifying areas and specialized situations where consultation is necessary and requiring personnel to refer to authoritative literature or other sources or consult, on a timely basis, with individuals within or outside the firm, when appropriate (for example, when dealing with complex, unusual, or unfamiliar issues).

## Monitoring

1.15. The objective of the *Monitoring* element of a system of quality control is to provide the firm with reasonable assurance that the policies and procedures relating to the other elements of quality control are suitably designed and being effectively applied. Monitoring is an ongoing consideration and evaluation process.

1.16. This objective ordinarily would be satisfied by establishing and maintaining policies for considering and evaluating, on an ongoing basis—

- The relevance and adequacy of the firm's quality control policies and procedures.
- The appropriateness of the firm's guidance materials and any practice aids.
- The effectiveness of professional development activities.
- Compliance with the firm's policies and procedures.

## Illustrative Examples

1.17. The remainder of this Guide provides illustrative examples of the types of policies a firm should consider for each of the elements of quality control. Each chapter provides examples of procedures that a firm might consider in implementing and maintaining such policies. The specific policies and procedures used by a firm would not necessarily include all those described or be limited to those illustrated. Most firms will find it appropriate to communicate their policies and procedures in writing. These examples are based on the assumption that each firm's

quality control policies and procedures are in writing and distributed to all personnel. The illustrative examples are provided through four hypothetical firms—National CPA Firm, Regional Accountants, AnyCity CPAs, and Jane Brown, CPA—with the following characteristics:

- a.* National CPA Firm is one of the largest firms in the country. It has sixty offices, eight hundred partners, five thousand professionals, five hundred publicly held clients, and it performs services for clients in a variety of industries. (Chapter 2)
- b.* Regional Accountants has ten offices in three states and is centrally managed. Regional has thirty-five partners, two hundred professionals, and twenty-five SEC clients. In addition to servicing SEC clients, it has a concentration in audit and attest services for financial institutions. (Chapter 3)
- c.* AnyCity CPAs is a local, one-office firm with three partners and ten professionals. Its accounting and auditing practice includes a concentration in employee benefit plan audits. AnyCity CPAs has no SEC clients. (Chapter 4)
- d.* Jane Brown, CPA, is a sole owner without any professional staff, who occasionally hires per diem professionals. Her accounting practice consists only of services performed under Statements on Standards for Accounting and Review Services (SSARs). (Chapter 5)

## Chapter 2

# National CPA Firm's System of Quality Control for Its Accounting and Auditing Practice

2.01. This chapter describes how National CPA Firm implements each element of quality control for its accounting and auditing practice. National CPA Firm is a hypothetical firm. It is presumed to be one of the largest firms in the country. It has sixty offices, eight hundred partners, five thousand professionals, and five hundred publicly held clients, and performs services for clients in a variety of industries.

## Independence, Integrity, and Objectivity

2.02. The objective of the *Independence, Integrity, and Objectivity* element of a system of quality control is to provide the firm with reasonable assurance that personnel maintain independence (in fact and in appearance) in all required circumstances, perform all professional responsibilities with integrity, and maintain objectivity in discharging professional responsibilities.

2.03. National CPA Firm satisfies this objective by establishing and maintaining the following policies and procedures.

### 2.04. Policy 1

**Personnel will adhere to applicable independence, integrity, and objectivity requirements. These requirements include regulations, interpretations, and rulings of the AICPA, state CPA societies, state boards of accountancy, state statutes, the Securities and Exchange Commission, and other regulatory agencies where applicable.**

2.05. National CPA Firm implements this policy by—

- a. Developing and maintaining a Professional Practice Manual that contains policies and procedures relating to independence, integrity, and objectivity. Such policies and procedures contain the firm's interpretations of professional and regulatory requirements, and guidance for identifying and resolving potential issues.
- b. Designating a quality assurance partner in each office to provide guidance, answer questions, and resolve matters.
- c. Designating a partner in its national office to answer more complex matters and determine the circumstances that might require consultation with sources outside the firm.
- d. Identifying circumstances where documentation of the resolution of matters is appropriate.
- e. Obtaining written representations from personnel, upon hire and on an annual basis, stating whether they are familiar with and are in compliance with professional standards and the firm's policies and procedures regarding independence, integrity, and objectivity. The quality assurance partner in each office is responsible for obtaining such representations and reviewing compliance files for completeness. A partner in its national office is responsible for resolving reported exceptions.
- f. Requiring the managing partner in each office to periodically review unpaid fees from clients to ascertain whether any outstanding amounts impair the firm's independence.

2.06. Policy 2

<p><b>Personnel will be familiar with policies and procedures relating to independence, integrity, and objectivity.</b></p>
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2.07. National CPA Firm implements this policy by—

- a. Providing each of its personnel with access to a personal computer and software that has access to databases containing professional and regulatory literature and advising them that they are expected to be familiar with that literature.
- b. Emphasizing the concepts of independence, integrity, and objectivity in its professional development meetings, in the acceptance and continuance of clients and engagements, and in the performance of engagements, including discussing the types of nonattest services that could impact independence.

- c. Informing personnel on a timely basis of those entities to which independence policies apply, by—
  - (1) Preparing and maintaining lists of entities to which independence policies apply.
  - (2) Making the lists available to personnel who need them to determine their independence (including personnel new to the firm or to an office, and certain former partners<sup>1</sup>).
  - (3) Notifying personnel of changes in the lists on a timely basis via a memorandum or the firm's E-mail system.

### 2.08. Policy 3

**Confirm the independence of another firm performing parts of an engagement, or when we act as principal auditor.**

- 2.09. National CPA Firm implements this policy by—
- a. Describing in its Professional Practice Manual the form, content, and frequency of independence representations that are to be obtained.
  - b. Requiring that such representations be documented.

## Personnel Management

2.10. The objective of the *Personnel Management* element of a system of quality control is to provide the firm with reasonable assurance that all personnel have the proficiency to perform their assigned responsibilities. Attributes or qualities that enhance the proficiency of personnel who perform, supervise, or review work include integrity, objectivity, intelligence, judgment, competence, experience, and motivation.

2.11. National CPA Firm satisfies this objective by establishing and maintaining the following policies and procedures.

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<sup>1</sup>AICPA's *Professional Standards*, vol. 2, ET sec. 101.04, discusses circumstances when activities of a former practitioner could affect the firm's independence.



## 2.12. Policy 1

**Personnel who are hired will possess the appropriate characteristics to enable them to perform competently.**

2.13. National CPA Firm implements this policy by—

- a. Maintaining a national human resource function that establishes the firm's hiring objectives and evaluates the firm's personnel needs, including—
  - Designating a partner in its national office to be responsible for evaluating the firm's overall personnel needs and establishing hiring objectives based on factors such as clientele, anticipated growth, personnel turnover, and individual advancement.
  - Developing and maintaining a Human Resource Manual that identifies attributes, achievements, and experiences desired in entry-level and experienced personnel.
  - Establishing criteria to evaluate personal characteristics such as integrity, competence, and motivation.
  - Setting guidelines for additional procedures that are necessary when hiring experienced personnel, such as performing background checks and inquiring about any outstanding regulatory actions.
- b. Designating a qualified individual in each practice office to be responsible for managing the human resource function. This individual's responsibilities include—
  - Preparing budgets of personnel needs for all levels.
  - Identifying sources of employment candidates such as universities and executive recruiters, and coordinating the hiring process within the practice office.
  - Selecting and training those individuals who will be interviewing candidates or otherwise participating in the hiring process.
  - Summarizing and evaluating the results of the hiring process for each candidate and providing final approval for hiring.

## 2.14. Policy 2

**The firm will make personnel assignments based on the degree of technical training and proficiency required in the circumstances and the nature and extent of supervision to be provided.**

2.15. National CPA Firm implements this policy by designating an appropriate person in each office to be responsible for assigning personnel to engagements based on such factors as—

- Engagement size and complexity.
- Specialized experience or expertise required.
- Personnel availability and involvement of supervisory personnel.
- Timing of the work to be performed.
- Continuity and rotation of personnel.
- Opportunities for on-the-job training.
- Situations where independence or objectivity concerns exist.

For partner and manager assignments, such person shall be a partner, and in the case of high-risk engagements, approval of the partner assignment is to be obtained from the industry partner or the quality assurance partner.

### 2.16. Policy 3

**Personnel will participate in general and industry-specific continuing professional education and professional development activities that enable them to satisfy responsibilities assigned and fulfill applicable continuing professional education requirements of the AICPA and regulatory agencies.**

2.17. National CPA Firm implements this policy by—

- a. Maintaining a national professional development group to develop firm requirements and program materials for professional development and assigning responsibility for the professional development function to the Director of Professional Development. The group's responsibilities include—
  - Setting guidelines for participation by personnel in professional development programs and considering the requirements of the AICPA, state boards of accountancy, and regulatory agencies in establishing the firm's CPE requirements.
  - Maintaining appropriate documentation evidencing that personnel have met the professional educational requirements of the firm, the AICPA, and other regulatory bodies.
  - Providing an orientation program and training for newly employed personnel to inform them of their professional responsibilities and the firm's policies.

- Preparing publications and programs designed to inform personnel of their responsibilities and opportunities.
  - Developing in-house staff training programs that focus on general and industry-specific accounting and auditing subject matter.
- b. Assigning responsibility to an office or industry partner to establish a professional development program that provides that personnel in the office or those serving clients in an industry participate in professional development activities in accordance with firm guidelines and in subjects that are relevant to their responsibilities.
  - c. Communicating and distributing to personnel changes in accounting, auditing, and independence, integrity, and objectivity requirements and the firm's guidance with respect to them.
  - d. Encouraging participation in other professional development activities for personnel at each level within the firm, such as participation in external professional development programs, including graduate-level university and self-study courses, membership in professional organizations, serving on professional committees, and writing for professional publications.

#### 2.18. Policy 4

**Personnel selected for advancement will have the qualifications necessary to fulfill the responsibilities they will be called on to assume.**

- 2.19. National CPA Firm implements this policy by—
- a. Maintaining a national human resource function to identify and communicate, in the firm's Human Resource Manual, the qualifications necessary to fulfill responsibilities at each professional level within the firm by—
    - (1) Establishing the criteria for evaluating personnel at each professional level and for advancement to the next higher level of responsibility.
    - (2) Developing evaluation forms for each professional staff classification.
  - b. Assigning responsibility to a partner in each office for making advancement and termination decisions for staff and recommendations for manager- and partner-level advancements and terminations to the firm's management committee. Such responsibilities should include—

- (1) Identifying responsibilities and requirements for evaluations at each level indicating who will prepare the evaluations and when they will be prepared.
  - (2) Reviewing evaluations with the individual being evaluated on a timely basis.
- c. Counseling personnel regarding their progress and career opportunities by—
  - (1) Annually summarizing and reviewing with personnel the evaluation of their performance, including an assessment of their progress with the firm. Considerations should include performance, future objectives of the firm and the individual, assignment preferences, and career opportunities.
  - (2) Annually evaluating partners by means of counseling, peer evaluation, or self-appraisal, as appropriate, regarding whether they continue to have the qualifications to fulfill their responsibilities or to assume added responsibilities.

## **Acceptance and Continuance of Clients and Engagements**

2.20. The objective of the *Acceptance and Continuance of Clients and Engagements* element of a system of quality control is to establish criteria for deciding whether to accept or continue a client relationship and whether to perform a specific engagement for that client. Such policies and procedures should provide the firm with reasonable assurance that (a) the likelihood of association with a client whose management lacks integrity is minimized, (b) the firm undertakes only those engagements that can be completed with professional competence, (c) the risks associated with providing professional services in particular circumstances are appropriately considered, and (d) an understanding with the client regarding the services to be performed is reached.

2.21. National CPA Firm satisfies this objective, both with respect to the initial period for which the firm is performing its service and for subsequent periods, by establishing and maintaining the following policies and procedures.

## 2.22. Policy 1

**The firm will evaluate factors that have a bearing  
on management's integrity.**

2.23. National CPA firm implements this policy by—

- a. Developing and maintaining a Professional Practice Manual that contains policies and procedures relating to the acceptance of prospective clients and the continuance of current clients. Such policies and procedures state that the firm's clients should not present undue risks to the firm, including damage to the firm's reputation.
- b. Advising personnel that they are expected to be familiar with the firm's policies and procedures for acceptance and continuance of clients.
- c. Obtaining and evaluating information before accepting or continuing a client, as applicable:
  - (1) Available information regarding the client and its operations from sources such as annual reports, interim financial statements, registration statements, Form 10-K, Form 8-K, other reports to regulatory agencies, enforcement actions by regulatory agencies, and income tax returns.
  - (2) The nature and purpose of the services to be provided by making inquiries of client management.
  - (3) Information regarding the client and its management and principals that may have a bearing on evaluating the client by making inquiries of third parties such as bankers, legal counsel, investment bankers, underwriters, and other members of the financial or business community who may have appropriate knowledge. Inquiries might also be made about management's attitude toward compliance with outside regulatory or legislative requirements and the presence of reportable conditions, especially those that management is unwilling to correct. In certain circumstances, background checks by investigative firms are required.
- d. Communicating with the predecessor accountant when required or suggested by professional standards. This communication also includes inquiries regarding the nature of any disagreements, and other events required to be reported by Form 8-K, and whether evidence of "opinion shopping" exists.

- e. Evaluating the information obtained regarding management's integrity.

#### 2.24. Policy 2

**The firm will evaluate whether the engagement can be completed with professional competence and accordingly undertake only those engagements that can be completed with professional competence and appropriately consider the risk associated with providing professional services in particular circumstances.**

#### 2.25. National CPA Firm implements this policy by—

- a. Evaluating whether the practice office has obtained or can reasonably expect to obtain the knowledge and expertise necessary to enable it to perform the engagement, for example, through use of other practice offices' resources.
- b. Specifying conditions that require evaluation of a specific client or engagement, obtaining relevant information to determine whether the relationship should be continued, and establishing a time period for evaluations to be made (for example, continuance decisions should be made at least annually). Conditions include the following:
- Significant changes in the client, for example, a major change in ownership, senior personnel, directors, advisors, the nature of its business, or its financial stability.
  - Changes in the nature or scope of the engagement, including requests for additional services.
  - Changes in the strategic focus or composition of the firm, for example, a decision to discontinue services to clients in a particular industry.
  - The existence of conditions that would have caused the firm to reject the engagement had such conditions existed at the time of the initial acceptance. These conditions may include unreliable processes for making accounting estimates, questionable estimates by management, questions regarding the entity's ability to continue as a going concern, or other factors that may increase the risk of being associated with the client.
  - Client delinquent in paying fees. (This may also affect the firm's independence.)
  - Engagements for entities operating in highly specialized or regulated industries, including financial institutions, governmental entities, and engagements for employee benefit plans.

- Engagements for entities in the development stage.
- c. Evaluating the information obtained regarding the acceptance or continuance of the client or engagement.
  - (1) All information obtained about the client or the specific engagement is to be evaluated by the engagement partner and a recommendation is made regarding whether the client or engagement should be accepted or continued.
  - (2) The engagement partner completes a client acceptance form and submits it to the practice office managing partner for approval.
  - (3) The engagement partner signs a step in the planning program noting client continuance, and a form documenting client continuance is completed if conditions identified above (paragraph 2.25b) exist.
  - (4) The managing partner of the practice office is responsible for evaluating and approving the recommendation made by the engagement partner. In certain defined circumstances, such as new SEC engagements and high-risk engagements, documented acceptance may also require the approval of the national office.

## 2.26. Policy 3

**The firm will obtain an understanding with the client regarding the services to be performed.**

2.27. National CPA Firm implements this policy by requiring that all understandings with the client be in writing by obtaining an engagement letter for all engagements, thus minimizing the risk of misunderstandings regarding the nature, scope, and limitations of the services to be performed.

## Engagement Performance

2.28. The objective of the *Engagement Performance* element of a system of quality control is to provide the firm with reasonable assurance that the work performed by engagement personnel meets the applicable professional standards, regulatory requirements, and the firm's standards of quality. Policies and procedures for engagement perfor-

mance encompass all phases of the design and execution of the engagement. To the extent appropriate and as required by applicable professional standards, these policies and procedures should cover planning, performing, supervising, reviewing, documenting, and communicating the results of each engagement. Policies and procedures should also provide that personnel refer to authoritative literature or other sources and consult, on a timely basis, with individuals within or outside the firm, when appropriate.

2.29. National CPA Firm satisfies this objective by establishing and maintaining the following policies and procedures.

### 2.30. Policy 1

**Planning for engagements will meet professional, regulatory,  
and the firm's requirements.**

2.31. National CPA Firm implements this policy by developing, maintaining, and providing personnel with the firm's Professional Practice Manual, which prescribes the factors to be considered in the planning process by the engagement team and the extent of documentation of the considerations which may vary depending on the size and complexity of the engagement. Planning considerations include—

- Making the engagement partner or another qualified individual responsible for planning an engagement and assigning responsibilities to appropriate personnel during the planning phase.
- Developing or updating background information.
- Requiring planning documentation that includes—
  - Development of proposed work program, tailored to the specific engagement.
  - Staffing requirements and the need for specialized knowledge, which may have to be obtained from another practice office.
  - Considering economic conditions affecting the client or its industry and their potential impacts on the conduct of the engagement.
  - Considering risks and how they may affect the procedures to be performed.
  - Preparing a budget that allocates a sufficient amount of time so the engagement will be performed in accordance with professional standards and the firm's quality control policies and procedures.



## 2.32. Policy 2

**The engagement will be performed, supervised, reviewed, documented, and communicated in accordance with the requirements of professional standards, regulatory authorities, and the firm.**

- 2.33. National CPA Firm implements this policy by—
- a. Providing personnel with the firm's Professional Practice Manual, which—
    - (1) Prescribes the form and content of working papers, including firm-generated forms, checklists, and questionnaires that are to be used in the performance of engagements, the form in which instructions are given to other offices or correspondents, and the extent to which their work is reviewed and documented.
    - (2) Specifies the extent of overall engagement review at all professional levels so that the financial statements meet professional and firm presentation and disclosure standards.
    - (3) Specifies the extent of review that should be performed of communications to be made to management and the board of directors.
  - b. Assigning responsibility for the review of all reports, financial statements, and working papers to a reviewer senior to the preparer in accordance with procedures outlined in the firm's Professional Practice Manual to obtain reasonable assurance that—
    - (1) The nature, timing, and extent of procedures performed are consistent with risk assessments made and the approach described in the planning documentation and that exceptions are appropriately investigated. The appropriateness of planned procedures should be reconsidered when significant changes in risk factors occur or are identified between the planning phase of the engagement and the execution of substantive procedures.
    - (2) Firm-prescribed forms, checklists, and questionnaires, tailored as appropriate, are used in the performance of the engagement and reporting on it.
  - c. Requiring a second review of the report, financial statements, and selected working papers by a partner or manager as prescribed in the firm's Professional Practice Manual. The extent of review varies based on the type of engagement; for example, audits of SEC

clients and high-risk engagements, as defined by the firm, receive the most extensive review.

- d. Adhering to the following guidelines set up by the firm regarding the review of working papers, financial statements, and for documentation of the review process:
  - (1) All reviewers are to have appropriate experience, competence, and responsibility.
  - (2) All work performed and the reports and financial statements issued are to be complete and comply with professional standards and firm policy.
  - (3) Appropriate documentation is required on all engagements evidencing review of working papers, financial statements, and reports. Necessary documentation includes completion of the firm's review and approval documentation.
- e. Requiring that differences of professional judgment within an engagement team or with consultants be resolved with the assistance of the office's quality assurance partner and a designated partner in the firm's national office, where applicable. The resolution of the differences must be appropriately documented. If a member of the team continues to disagree with the resolution, he or she may disassociate himself or herself from the resolution of the matter and will be offered the opportunity to document that a disagreement still exists.

### 2.34. Policy 3

**The firm will identify areas and specialized situations where consultation is required and will require personnel to refer to authoritative literature and practice aids and to consult, on a timely basis, with individuals within or outside the firm when appropriate (for example, when dealing with complex, unusual, or unfamiliar issues).**

### 2.35. National CPA Firm implements this policy by—

- a. Providing personnel with the firm's Professional Practice Manual, which specifies the firm's consultation policies and procedures. Areas or specialized situations that may require consultation include—
  - Application of newly issued technical pronouncements.
  - Industries with special accounting, auditing, or reporting requirements.

- Emerging practice problems.
  - Choices among alternative generally accepted accounting principles upon initial adoption or when an accounting change is made.
  - Reissuance of a report, consideration of omitted procedures after a report has been issued, or subsequent discovery of facts that existed at the time a report was issued.
  - Filing requirements of regulatory agencies.
  - Meetings with the SEC and other regulators, at which the firm is to be called on to support the applications of generally accepted accounting principles which have been questioned.
- b. Designating individuals within the firm as consultants in certain areas. Personnel are to consult with the appropriate individual when issues arise, as specified in the firm's manuals. When differences arise between the engagement partner and the consultant, all resolutions are determined by the office quality assurance partner and, if it continues to be unresolved, a designated national office partner.
- c. Maintaining or providing access to adequate and up-to-date reference libraries in each office, which include materials related to specific industries and regulatory requirements.
- d. Requiring that documentation of consultation include all relevant facts and circumstances, reference to professional literature used in the determination, the conclusions reached, and signatures of the engagement partner and consultant. This documentation is to be retained in the engagement working papers and, at the discretion of the consultant, entered in a retrievable database to promote consistency in the application of generally accepted accounting principles in similar circumstances.

## Monitoring

2.36. The objective of the *Monitoring* element of a system of quality control is to provide the firm with reasonable assurance that the policies and procedures relating to the other elements of quality control are suitably designed and being effectively applied. Monitoring is an ongoing consideration and evaluation process.

2.37. National CPA Firm satisfies this objective by establishing and maintaining the following policies and procedures.

## 2.38. Policy 1

**The firm will consider and evaluate, on an ongoing basis, the relevance and adequacy of its quality control policies and procedures.**

2.39. National CPA Firm implements this policy by designating a partner or group in its national office to be responsible for quality assurance, including—

- a. Assuring that the firm's quality control policies and procedures and its audit methodology remain relevant and adequate. Factors to be considered include—
  - Mergers and divestitures of portions of the practice.
  - Changes in professional standards and SEC or other regulatory requirements applicable to the firm's practice.
  - Results of annual inspections and peer reviews.
  - Review of litigation and regulatory enforcement actions against the firm and others.
  - The impact that changes in technology may have on clients' methods of doing business.
  - Changes in clients' industries that impact their operations.
  - Changes in applicable AICPA membership requirements.
- b. Determining whether personnel have been appropriately informed of their responsibilities for maintaining the firm's standards of quality in performing their duties.
- c. Identifying the need to—
  - (1) Revise policies and procedures related to the other elements of quality control because they are ineffective or inappropriately designed.
  - (2) Improve compliance with firm policies and procedures that are related to the other elements of quality control.

## 2.40. Policy 2

**The firm will consider and evaluate, on an ongoing basis, the appropriateness of its guidance materials and any practice aids.**

2.41. National CPA Firm implements this policy by—

- a. Reviewing and updating firm practice aids, such as audit programs, forms, and checklists, based on the issuance of new professional pronouncements.
- b. Issuing professional practice alerts to notify and provide guidance to personnel regarding new professional standards, regulatory requirements, and related changes to firm policy.
- c. Having national office personnel periodically visit offices and interview partners and managers regarding the effectiveness of practice aids and tools.

**2.42. Policy 3**

**The firm will consider and evaluate, on an ongoing basis, the effectiveness of professional development programs.**

2.43. National CPA Firm implements this policy by—

- a. Having the National Professional Development Group review the summary of evaluations of national training programs to determine whether the national professional development programs are achieving their objectives.
- b. Having the National Professional Development Group review the overall professional development plan to determine whether professional staff are receiving the appropriate mix of in-house training, AICPA or state society classroom training, and self-study programs.
- c. Having the National Professional Development Group review summaries of CPE records for the firm's professional staff to determine that each practice office has established a means of tracking each professional's compliance with the requirements of the firm, the AICPA, and other regulatory bodies.
- d. Interviewing selected professional personnel regarding the effectiveness of training programs.
- e. Considering the results of the firm's inspection procedures in connection with the effectiveness of the firm's professional development program.
- f. Ascertaining whether inquiries received by individuals consulted within the firm indicate the need for additional CPE programs.

## 2.44. Policy 4

**The firm will consider and evaluate, on an ongoing basis, compliance with its policies and procedures.**

2.45. National CPA Firm implements this policy by making its national quality assurance partner responsible for the preparation of checklists and practice aids to be used in performing monitoring and inspection procedures. These procedures include—

- Developing and coordinating the firm's inspection program to achieve feedback about the effectiveness of the firm's policies and procedures.
- Developing a plan for an appropriate test of compliance with the firm's policies and procedures on a sample of engagements. Such a review could be preissuance or postissuance.
- Reviewing correspondence prepared by national office personnel regarding consultation on independence, integrity, and objectivity matters, acceptance and continuance decisions, and engagement performance.
- Reviewing the resolution of matters reported by professional personnel on independence circularization forms to determine that matters have been appropriately considered and resolved.
- Interviewing personnel at all professional management and staff levels to obtain information regarding operating procedures in practice offices and to determine whether personnel are knowledgeable of firm policies and procedures and whether they are being effectively communicated.
- Reviewing the following documentation to determine compliance with firm policies and procedures:
  - a. Personnel evaluations, including documentation of hiring and advancement decisions
  - b. Documentation of client acceptance and continuance decisions
  - c. Participants' evaluations of training programs
  - d. Professional development records of professional personnel
  - e. Correspondence regarding the resolution of independence matters within the practice office
- Reviewing a cross-section of engagements that have had a preissuance or postissuance review from selected practice offices using the following criteria:

- a.* All partners and those managers who have significant accounting and auditing responsibilities in the selected offices
  - b.* Significant specialized industries with emphasis given to high-risk industries
  - c.* First-year engagements
  - d.* Level of service performed (that is, audit, review, compilation, and agreed-upon procedures)
  - e.* Level of attestation services performed (that is, examination, review, and agreed-upon procedures)
- Periodically summarizing and communicating inspection findings to firm personnel on a timely basis.
- Communicating findings to practice office personnel and determining the corrective actions to be taken on the engagements reviewed. These findings are discussed and communicated in a report issued to each office. The practice office responds regarding the specific corrective actions or steps to be taken to improve compliance with the firm's policies and procedures and professional standards.
- Communicating the need for improved compliance with or changes to the system of quality control in training programs, partner or manager meetings, and firm policy correspondence.
- Preparing a summary inspection report that evaluates the overall results of the inspection to determine whether—
  - a.* The firm as a whole needs to improve compliance with the firm's policies and procedures.
  - b.* Revisions to the firm's quality control policies and procedures are necessary.
- Periodically reviewing the system of personnel evaluation and counseling to ascertain that—
  - a.* Procedures for evaluation and documentation are being followed on a timely basis.
  - b.* Requirements established for advancement are being achieved.
  - c.* Personnel decisions are consistent with evaluations.
  - d.* Recognition is given to outstanding performance.

## Chapter 3

# Regional Accountants' System of Quality Control for Its Accounting and Auditing Practice

3.01. This chapter describes how Regional Accountants implements each element of quality control for its accounting and auditing practice. Regional Accountants is a hypothetical firm. It is presumed to have ten offices in three states and to be centrally managed. Regional has thirty-five partners, two hundred professionals and twenty-five SEC clients. In addition to servicing SEC clients, it has a concentration in audit and attest services for financial institutions.

## Independence, Integrity, and Objectivity

3.02. The objective of the *Independence, Integrity, and Objectivity* element of a system of quality control is to provide the firm with reasonable assurance that personnel maintain independence (in fact and in appearance) in all required circumstances, perform all professional responsibilities with integrity, and maintain objectivity in discharging professional responsibilities.

3.03. Regional Accountants satisfies this objective by establishing and maintaining the following policies and procedures.

### 3.04. Policy 1

**Personnel will adhere to applicable independence, integrity, and objectivity requirements. These requirements include regulations, interpretations, and rulings of the AICPA, state CPA societies, state boards of accountancy, state statutes, the Securities and Exchange Commission, and other regulatory agencies where applicable.**



3.05. Regional Accountants implements this policy by—

- a. Developing and maintaining a manual that contains the firm's policies and procedures relating to independence, objectivity, and integrity. Such policies and procedures contain the firm's interpretations of professional and regulatory requirements, and guidance for identifying and resolving potential issues or situations.
- b. Designating one of its partners to provide guidance, answer questions and resolve matters, and determine the circumstances that might require consultation with sources outside the firm.
- c. Identifying circumstances where documentation of the resolution of matters is appropriate.
- d. Obtaining written representations from personnel, upon hire and on an annual basis, stating whether they are familiar with and are in compliance with professional standards and the firm's policies and procedures regarding independence, integrity, and objectivity.
- e. Assigning responsibility for obtaining such representations, reviewing compliance files for completeness, and resolving reported exceptions to the firm's quality control partner.
- f. Requiring the managing partner in each office to periodically review unpaid fees from clients to ascertain whether any outstanding amounts impair the firm's independence.

### 3.06. Policy 2

**Personnel will be familiar with policies and procedures relating to independence, integrity, and objectivity.**

3.07. Regional Accountants implements this policy by—

- a. Providing personnel with access to a computer and software that has access to databases containing professional and regulatory literature and advising them that they are expected to be familiar with that literature.
- b. Emphasizing the concepts of independence, integrity, and objectivity in its professional development meetings, in the acceptance and continuance of clients and engagements, and in the performance of engagements, including discussing the implications regarding engagements for financial institutions, such as the prohibition of any member of the engagement team having a loan with the institution, and the types of nonattest services that could affect independence.

- c. Informing personnel on a timely basis of those entities to which independence policies apply, by—
  - (1) Preparing and maintaining lists of entities to which independence policies apply.
  - (2) Making the lists available to personnel who need them to determine their independence (including personnel new to the firm or to an office, and certain former partners<sup>1</sup>).
  - (3) Notifying personnel of changes in the lists on a timely basis via a memorandum or the firm's E-mail system.

### 3.08. Policy 3

**Confirm the independence of another firm performing parts of an engagement, or when we act as principal auditor.**

- 3.09. Regional Accountants implements this policy by—
- a. Describing in its policies and procedures manual the form, content, and frequency of independence representations that are to be obtained.
  - b. Requiring that such representations be documented.

## Personnel Management

3.10. The objective of the *Personnel Management* element of a system of quality control is to provide the firm with reasonable assurance that all personnel have the proficiency to perform their assigned responsibilities. Attributes or qualities that enhance the proficiency of personnel who perform, supervise, or review work include integrity, objectivity, intelligence, judgment, competence, experience, and motivation.

3.11. Regional Accountants satisfies this objective by establishing and maintaining the following policies and procedures.

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<sup>1</sup>AICPA's *Professional Standards*, vol. 2, ET sec. 101.04, discusses circumstances when activities of a former practitioner could affect the firm's independence.

### 3.12. Policy 1

**Personnel who are hired will possess the appropriate characteristics to enable them to perform competently.**

3.13. Regional Accountants implements this policy by maintaining firm-wide hiring objectives and evaluating the firm's personnel needs, including—

- Designating a partner or a qualified individual in each office to be responsible for evaluating that practice office's overall personnel needs and establishing hiring objectives based on factors such as clientele, anticipated growth, personnel turnover, and individual advancement.
- Developing and maintaining personnel policies and procedures that identify attributes, achievements, and experiences desired in entry-level and experienced personnel.
- Establishing criteria to evaluate personal characteristics such as integrity, competence, and motivation.
- Setting guidelines as to additional procedures that are necessary when hiring experienced personnel, such as performing background checks and inquiring about any outstanding regulatory actions.
- Identifying sources of employment candidates such as universities and executive recruiters, and coordinating the hiring process within the practice office.
- Selecting and training the individuals who will be interviewing candidates or otherwise participating in the hiring process.
- Summarizing and evaluating the results of the hiring process for each candidate and providing final approval for hiring.

### 3.14. Policy 2

**The firm will make personnel assignments based on the degree of technical training and proficiency required in the circumstances and the nature and extent of supervision to be provided.**

3.15. Regional Accountants implements this policy by—

- a. Designating an appropriate person in each office to be responsible for assigning personnel to engagements based on such factors as—

- Engagement size and complexity.
  - Specialized experience and expertise required.
  - Personnel availability and involvement of supervisory personnel.
  - Timing of the work to be performed.
  - Continuity and rotation of personnel.
  - Opportunities for on-the-job training.
  - Situations where independence or objectivity concerns exist.
- b. Designating the quality control partner as the person responsible for approval of the partner assignments on high-risk engagements.

### 3.16. Policy 3

**Personnel will participate in general and industry-specific continuing professional education and professional development activities that enable them to satisfy responsibilities assigned and fulfill applicable continuing professional education requirements of the AICPA and regulatory agencies.**

- 3.17. Regional Accountants implements this policy by—
- a. Designating one partner responsible for developing firm requirements and program materials for professional development. These responsibilities include—
- Setting guidelines for participation by personnel in professional development programs, and considering requirements of the AICPA, state boards of accountancy, and regulatory agencies in establishing the firm's CPE requirements.
  - Maintaining appropriate documentation evidencing that personnel have met the professional education requirements of the firm, the AICPA, and other regulatory bodies.
  - Providing an orientation program and training for newly employed personnel to inform them of their professional responsibilities and firm policies.
  - Preparing publications and programs designed to inform personnel of their responsibilities and opportunities.
  - Developing in-house staff training programs that focus on general and industry-specific accounting and auditing subject matter, including audits of financial institutions.
- b. Assigning responsibility to an office or industry partner to maintain a professional development program that provides that personnel in

the office or those serving clients in an industry participate in professional development activities in accordance with firm guidelines and in subjects that are relevant to their responsibilities.

- c. Communicating and distributing to personnel changes in accounting, auditing, and independence, integrity, and objectivity requirements and the firm's guidance with respect to them.
- d. Encouraging participation in other professional development activities for personnel at each level within the firm, such as participation in external professional development programs, including graduate level and self-study courses, membership in professional organizations, serving on professional committees, and writing for professional publications.

### 3.18. Policy 4

**Personnel selected for advancement will have the qualifications necessary to fulfill the responsibilities they will be called on to assume.**

3.19. Regional Accountants implements this policy by—

- a. Appointing a Director of Human Resources to identify and communicate in the firm's policies and procedures manual the qualifications necessary to fulfill responsibilities at each professional level within the firm by—
  - (1) Establishing the criteria for evaluating personnel at each professional level and for advancement to the next higher level of responsibility.
  - (2) Developing evaluation forms for each professional staff classification.
- b. Assigning responsibility to one of its partners for making advancement and termination decisions for staff and recommendations for manager- and partner-level advancements and terminations to the firm's management committee. Such responsibilities should include—
  - (1) Identifying responsibilities and requirements for evaluation at each level and indicating who will prepare evaluations and when they will be prepared.
  - (2) Reviewing evaluations with the individual being evaluated on a timely basis.

- c. Counseling personnel regarding their progress and career opportunities by—
- (1) Annually summarizing and reviewing with personnel the evaluation of their performance, including an assessment of their progress with the firm. Considerations should include performance, future objectives of the firm and the individual, assignment preferences, and career opportunities.
  - (2) Periodically evaluating partners by means of counseling, peer evaluation, or self-appraisal, as appropriate, regarding whether they continue to have the qualifications to fulfill their responsibilities or assume added responsibilities.

## **Acceptance and Continuance of Clients and Engagements**

3.20. The objective of the *Acceptance and Continuance of Clients and Engagements* element of a system of quality control is to establish criteria for deciding whether to accept or continue a client relationship and whether to perform a specific engagement for that client. Such policies and procedures should provide the firm with reasonable assurance that (a) the likelihood of associations with a client whose management lacks integrity is minimized, (b) the firm undertakes only those engagements that can be completed with professional competence, (c) the risks associated with providing professional services in particular circumstances are appropriately considered, and (d) an understanding with the client regarding the services to be performed is reached.

3.21. Regional Accountants satisfies this objective, both with respect to the initial period for which the firm is performing its service and for subsequent periods, by establishing and maintaining the following policies and procedures.

### **3.22. Policy 1**

<p><b>The firm will evaluate factors that have a bearing on management's integrity.</b></p>
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3.23. Regional Accountants implements this policy by—

- a. Developing and maintaining a policies and procedures manual that contains policies and procedures relating to acceptance of prospective clients and the continuance of current clients. Such policies and procedures state that the firm's clients should not present undue risks to the firm, including damage to the firm's reputation.
- b. Advising personnel that they are expected to be familiar with the firm's policies and procedures for acceptance and continuance of clients.
- c. Obtaining and evaluating information before accepting or continuing a client, as applicable:
  - (1) Available information regarding the client and its operations from sources such as annual reports, interim financial statements, registration statements, Form 10-K, Form 8-K, other reports to regulatory agencies, enforcement actions by regulatory agencies, and income tax returns.
  - (2) The nature and purpose of the services to be provided by making inquiries of client management.
  - (3) Information regarding the client and its management and principals that may have a bearing on evaluating the client by making inquiries of third parties such as bankers, legal counsel, investment bankers, underwriters, and other members of the financial or business community who may have appropriate knowledge. Inquiries might also be made about management's attitude toward compliance with outside regulatory or legislative requirements and the presence of reportable conditions, especially those that management is unwilling to correct. In certain circumstances, background checks by investigative firms are required.
- d. Communicating with the predecessor accountant when required or suggested by professional standards. This communication also includes inquiries regarding the nature of any disagreements and other events required to be reported by Form 8-K, and whether evidence of "opinion shopping" exists.
- e. Evaluating the information obtained regarding management's integrity.

### 3.24. Policy 2

**The firm will evaluate whether the engagement can be completed with professional competence and accordingly undertake only those engagements that can be completed with professional competence and appropriately consider the risk associated with providing professional services in particular circumstances.**

3.25. Regional Accountants implements this policy by—

- a. Evaluating whether the practice office has obtained or can reasonably expect to obtain the knowledge and expertise necessary to enable it to perform the engagement, for example, through the use of another practice office's resources.
- b. Specifying conditions that require evaluation of a specific client or engagement, obtaining relevant information to determine whether the relationship should be continued, and establishing a time period for evaluations to be made (for example, continuance decisions should be made at least annually). Conditions include the following:
  - Significant changes in the client, for example, a major change in ownership, senior client personnel, directors, advisors, the nature of its business, or its financial stability.
  - Changes in the nature or scope of the engagement, including requests for additional services.
  - Changes in the strategic focus or composition of the firm, for example, the inability to replace the loss of key personnel who are particularly knowledgeable about a specialized industry, or the decision to discontinue services to clients in a particular industry.
  - The existence of conditions that would have caused the firm to reject the engagement had such conditions existed at the time of the initial acceptance. These conditions may include unreliable processes for making accounting estimates, questionable estimates by management, questions regarding the entity's ability to continue as a going concern, and other factors that may increase the risk of being associated with the client.
  - Client delinquent in paying fees. (This may also affect the firm's independence.)
  - Engagements for entities operating in highly specialized or regulated industries, including financial institutions and governmental entities, and engagements for employee benefit plans.
  - Engagements for entities in the development stage.



- c. Evaluating the information obtained regarding the acceptance or continuance of the client or engagement.
- (1) All information obtained about the client or the specific engagement is evaluated by the engagement partner and a recommendation is made regarding whether the client or engagement should be accepted or continued.
  - (2) The engagement partner completes a client acceptance form and submits it to the practice office managing partner for approval.
  - (3) The engagement partner signs a step in the planning program noting client continuance, and a form documenting client continuance is completed if conditions identified above (paragraph 3.25b) exist.
  - (4) The firm's quality control partner is responsible for evaluating and approving the recommendation made by the engagement partner. In certain defined circumstances, such as new SEC engagements or high-risk engagements, documented acceptance or continuance decisions may also require the approval of the firm's managing partner.

### 3.26. Policy 3

<p style="text-align: center;"><b>The firm will obtain an understanding with the client regarding the services to be performed.</b></p>
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3.27. Regional Accountants implements this policy by requiring that all understandings with the client be in writing by obtaining an engagement letter for all engagements, thus minimizing the risk of misunderstandings regarding the nature, scope, and limitations of the services to be performed.

## Engagement Performance

3.28. The objective of the *Engagement Performance* element of a system of quality control is to provide the firm with reasonable assurance that the work performed by engagement personnel meets the applicable professional standards, regulatory requirements, and the firm's standards of quality. Policies and procedures for engagement

performance encompass all phases of the design and execution of the engagement. To the extent appropriate and as required by applicable professional standards, these policies and procedures should cover planning, performing, supervising, reviewing, documenting, and communicating the results of each engagement. Policies and procedures should also provide that personnel refer to authoritative literature or other sources and consult, on a timely basis, with individuals within or outside the firm when appropriate (for example, when dealing with complex, unusual, or unfamiliar issues).

3.29. Regional Accountants satisfies this objective by establishing and maintaining the following policies and procedures.

### 3.30. Policy 1

**Planning for engagements will meet professional, regulatory, and the firm's requirements.**

3.31. Regional Accountants implements this policy by developing, maintaining, and providing personnel with the firm's policies and procedures manual which prescribes the factors to be considered in the planning process by the engagement team and the extent of documentation of the considerations which may vary depending on the size and complexity of the engagement. Planning considerations include—

- Making the engagement partner responsible for planning an engagement and assigning responsibilities to appropriate personnel during the planning phase.
- Developing or updating background information.
- Requiring planning documentation that includes—
  - Development of proposed work program, tailored to the specific engagement.
  - Staffing requirements and the need for specialized knowledge, which may have to be obtained from another practice office.
  - Considering the economic conditions affecting the client or its industry and their potential impacts on the conduct of the engagement.
  - Considering the risks and how they may affect the procedures to be performed.
  - Preparing a budget that allocates a sufficient amount of time so the engagement will be performed in accordance with

professional standards and the firm's quality control policies and procedures.

### 3.32. Policy 2

**The engagement will be performed, supervised, reviewed, documented, and communicated in accordance with the requirements of professional standards, regulatory authorities, and the firm.**

3.33. Regional Accountants implements this policy by—

- a. Providing personnel with the firm's policies and procedures manual, which—
  - (1) Prescribes the form and content of working papers, including firm-generated or purchased forms, checklists, questionnaires that are to be used in the performance of engagements, the form in which instructions are given to other offices or correspondents, and the extent to which their work is reviewed and documented.
  - (2) Specifies the extent of overall engagement review, at all professional levels, so the financial statements meet professional and firm presentation and disclosure standards.
  - (3) Specifies the extent of review that should be performed of communications to be made to management and the board of directors.
- b. Assigning responsibility for the review of all reports, financial statements, and working papers to a reviewer senior to the preparer in accordance with procedures outlined in the firm's manual to obtain reasonable assurance that—
  - (1) The nature, timing, and extent of procedures performed are consistent with risk assessments made and the approach described in the planning documentation and that exceptions are appropriately investigated. The appropriateness of planned procedures should be reconsidered when significant changes in risk factors occur or are identified between the planning phase of the engagement and the execution of substantive procedures.
  - (2) Firm-prescribed forms, checklists, and questionnaires, tailored as appropriate, are used in the performance of the engagement and reporting on it.

- c. Requiring a second review of the report, financial statements, and selected working papers by a partner or manager as prescribed in the firm's policies and procedures manual. The extent of review varies based on the type of engagement; for example, audits of SEC clients, engagements for financial institutions and high-risk engagements, as defined by the firm, receive the most extensive review.
- d. Adhering to guidelines set up by the firm regarding the review of working papers, financial statements, and for documentation of the review process:
  - (1) All reviewers are to have appropriate experience, competence and responsibility.
  - (2) All work performed and the reports and financial statements issued are to be complete and comply with professional standards and firm policy.
  - (3) Appropriate documentation is required on all engagements evidencing review of working papers, financial statements, and reports. Necessary documentation includes completion of the firm's review and approval documentation.
- e. Requiring that all differences of professional judgment within an engagement team be resolved by the engagement and quality control partner. The resolution of the differences must be appropriately documented. If a member of the engagement team continues to disagree with the resolution, he or she may disassociate himself or herself from the resolution of the matter and will be offered the opportunity to document that a disagreement still exists.

### 3.34. Policy 3

**The firm will identify areas and specialized situations where consultation is required and will require personnel to refer to authoritative literature and practice aids and to consult, on a timely basis, with individuals within or outside the firm when appropriate (for example, when dealing with complex, unusual, or unfamiliar issues).**

- 3.35. Regional Accountants implements this policy by—
- a. Providing personnel with the firm's policies and procedures manual, which specifies the firm's consultation policies and procedures. Areas or specialized situations that may require consultation include—
    - Application of newly issued technical pronouncements.

- Industries with special accounting, auditing, or reporting requirements.
  - Emerging practice problems.
  - Choices among alternative generally accepted accounting principles upon initial adoption or when an accounting change is made.
  - Reissuance of a report, consideration of omitted procedures after a report has been issued or subsequent discovery of facts that existed at the time a report was issued.
  - Filing requirements of regulatory agencies.
  - Meetings with the SEC and other regulators at which the firm is to be called upon to support the application of generally accepted accounting principles which have been questioned.
- b. Designating individuals within the firm as consultants in certain areas. Personnel are to consult with the appropriate individual when issues arise. When differences arise between the engagement partner and the consultant, the matter is resolved by the firm's quality control partner.
  - c. Maintaining or providing access to adequate and up-to-date reference libraries in each office which include materials related to specific industries, specialties, and regulatory requirements.
  - d. Requiring that documentation of consultation include all relevant facts and circumstances, reference to professional literature used in the determination, the conclusion reached, and signatures of the engagement partner and consultant. This documentation is to be retained in the engagement working papers, and at the discretion of the consultant, entered in a retrievable database to promote consistency in the application of generally accepted accounting principles in similar circumstances.

## Monitoring

3.36. The objective of the *Monitoring* element of a system of quality control is to provide the firm with reasonable assurance that the policies and procedures relating to the other elements of quality control are suitably designed and being effectively applied. Monitoring is an ongoing consideration and evaluation process.

3.37. Regional Accountants satisfies this objective by establishing and maintaining the following policies and procedures.

### 3.38. Policy 1

**The firm will consider and evaluate, on an ongoing basis, the relevance and adequacy of its quality control policies and procedures.**

3.39. Regional Accountants implements this policy by designating a partner or a management-level individual with appropriate authority to be responsible for quality assurance, including—

- a. Assuring that the firm's quality control policies and procedures and its audit methodology remain relevant and adequate. Factors to be considered include—
  - Mergers and divestitures of portions of the practice.
  - Changes in professional standards, and SEC or other regulatory requirements applicable to the firm's practice.
  - Results of annual inspections and peer reviews.
  - Review of litigation and regulatory enforcement actions against the firm and others.
  - Impact that changes in technology may have on clients' methods of doing business.
  - Changes in clients' industries that impact their operations.
  - Changes in applicable AICPA membership requirements.
- b. Determining whether personnel have been appropriately informed of their responsibilities for maintaining the firm's standards of quality in performing their duties.
- c. Identifying the need to—
  - (1) Revise policies and procedures related to the other elements of quality control because they are ineffective or inappropriately designed.
  - (2) Improve compliance with firm policies and procedures that are related to the other elements of quality control.

### 3.40. Policy 2

**The firm will consider and evaluate, on an ongoing basis, the appropriateness of its guidance materials and any practice aids.**

3.41. Regional Accountants implements this policy by—

- a. Reviewing and updating firm practice aids, such as audit programs, forms, and checklists, based on the issuance of new professional pronouncements.
- b. Issuing guidance regarding new professional standards, regulatory requirements, and related changes to firm policy.
- c. Soliciting comments from partners and managers as to the effectiveness of practice aids and tools.

#### 3.42. Policy 3

**The firm will consider and evaluate, on an ongoing basis, the effectiveness of professional development programs.**

3.43. Regional Accountants implements this policy by—

- a. Designating a partner or qualified individual in each office to review the summary of evaluations of in-house training programs to determine whether the programs are achieving their objectives.
- b. Designating a partner or qualified individual in each office to review summaries of CPE records for that office's professional staff to determine that the office has established a means of tracking each individual's compliance with the requirements of the AICPA and other regulatory bodies.
- c. Interviewing selected professional personnel regarding the effectiveness of training programs.
- d. Considering the results of the firm's inspection in connection with the effectiveness of the firm's professional development program.
- e. Ascertaining whether inquiries received by individuals consulted within the firm indicate the need for additional CPE programs.

#### 3.44. Policy 4

**The firm will consider and evaluate, on an ongoing basis, compliance with its policies and procedures.**

3.45. Regional Accountants implements this policy by making its quality control partner responsible for preparing inspection checklists and guidance materials, or using materials prepared by the AICPA for performing inspection procedures. These procedures include—

- Developing and coordinating the firm's inspection program to achieve feedback about the effectiveness of the firm's policies and procedures.

- Developing a plan for an appropriate test of compliance with the firm's policies and procedures on a sample of engagements. Such a review could be preissuance or postissuance.
- Reviewing the resolution of matters reported by professional personnel on independence circularization forms to determine that matters have been appropriately considered and resolved.
- Interviewing personnel at all professional management and staff levels to obtain information regarding operating procedures in practice offices and to determine whether personnel are knowledgeable of firm policies and procedures and whether they are being effectively communicated.
- Reviewing the following documentation to determine compliance with firm policies and procedures:
  - a.* Personnel evaluations, including documentation of hiring and advancement decisions
  - b.* Documentation of client acceptance and continuance decisions
  - c.* Participants' evaluations of practice office training programs
  - d.* Professional development records of personnel
  - e.* Correspondence regarding the resolution of independence matters within the practice office
- Reviewing a cross-section of engagements from selected practice offices using the following criteria:
  - a.* All partners and managers who have significant accounting and auditing responsibilities in the selected offices
  - b.* Engagements for financial institutions
  - c.* First-year engagements
  - d.* Significant specialized industries with emphasis given to high-risk industries
  - e.* Level of service performed (that is, audit, review, compilation, and attestation)
  - f.* Level of attestation services performed (that is, examination, review, and agreed-upon procedures)
- Summarizing findings resulting from the inspection procedures.
- Communicating findings to practice office personnel and determining the corrective actions to be taken on the engagements reviewed. These findings are discussed and communicated in a report issued to each office. The practice office responds regarding the specific corrective actions or steps to be taken to improve com-



pliance with the firm's policies and procedures and professional standards.

- Preparing a summary inspection report to the firm's senior management that evaluates the overall results of the inspection to determine whether—
  - a.* The firm as a whole needs to improve compliance with the firm's policies and procedures.
  - b.* Revisions to the firm's quality control policies and procedures are necessary.
- Communicating the need for improved compliance with or changes to the system of quality control in training programs, partner manager meetings, and firm policy correspondence.
- Periodically reviewing the system of personnel evaluation and counseling to ascertain that—
  - a.* Procedures for evaluation and documentation are being followed on a timely basis.
  - b.* Requirements established for advancement are being achieved.
  - c.* Personnel decisions are consistent with evaluations.
  - d.* Recognition is given to outstanding performance.

## Chapter 4

# AnyCity CPAs' System of Quality Control for Its Accounting and Auditing Practice

4.01. This chapter describes how AnyCity CPAs implements each element of quality control for its accounting and auditing practice. AnyCity CPAs is a hypothetical firm. It is presumed to be a local, one-office firm with three partners and a total of ten professionals. Its accounting and auditing practice has a concentration of five employee benefit plan audits. AnyCity CPAs has no SEC clients. The firm uses purchased practice aids that have been subjected to peer review in accordance with standards established by the AICPA. These practice aids are supplemented by oral and written communications from the firm's partners. To enhance communications, the firm has chosen to provide its personnel with a written summary of its quality control policies and procedures that contains statements incorporated by reference to policies and procedures from its purchased practice aids, tailored to the specific needs of its practice.

## Independence, Integrity, and Objectivity

4.02. The objective of the *Independence, Integrity, and Objectivity* element of a system of quality control is to provide the firm with reasonable assurance that personnel maintain independence (in fact and in appearance) in all required circumstances, perform all professional responsibilities with integrity, and maintain objectivity in discharging professional responsibilities.

4.03. AnyCity CPAs satisfies this objective by establishing and maintaining the following policies and procedures.

#### 4.04. Policy 1

**Personnel will adhere to applicable independence, integrity, and objectivity requirements. These requirements include regulations, interpretations, and rulings of the AICPA, state CPA societies, state boards of accountancy, state statutes, and other regulatory agencies where applicable.**

#### 4.05. AnyCity CPAs implements this policy by—

- a. Designating a partner to provide guidance, answer questions, and resolve matters.
- b. Identifying circumstances where documentation of the resolution of matters is appropriate.
- c. Obtaining written representations from personnel, upon hire and on an annual basis, stating whether they are familiar with and are in compliance with professional standards and the firm's policies and procedures regarding independence, integrity, and objectivity.
- d. Assigning responsibility for obtaining representations, reviewing compliance files for completeness, and resolving reported exceptions to a partner.
- e. Having a partner periodically review unpaid fees from clients to ascertain whether any outstanding amounts impair the firm's independence.

#### 4.06. Policy 2

**Personnel will be familiar with policies and procedures relating to independence, integrity, and objectivity.**

#### 4.07. AnyCity CPAs implements this policy by—

- a. Subscribing to and updating the AICPA *Professional Standards* loose-leaf service and other services pertaining to its practice, including a service that contains the Department of Labor's rules and regulations, and making these available in its office library.
- b. Emphasizing the concepts of independence, integrity, and objectivity during its staff meetings, in the acceptance and continuance of clients and engagements, and in the performance of engagements, including discussing implications of auditing employee benefit plans and the types of nonattest services that could affect independence.

- c. Informing personnel on a timely basis of those entities to which independence policies apply, by—
  - (1) Preparing and maintaining a list of entities to which independence applies.
  - (2) Making the list available to personnel who need it to determine their independence (including personnel new to the firm and certain former partners<sup>1</sup>).
  - (3) Notifying personnel of changes in the list on a timely basis via memorandum or the firm's E-mail system.

#### 4.08. Policy 3

**Confirm the independence of another firm performing parts of an engagement, or when we act as principal auditor.**

4.09. AnyCity CPAs implements this policy by—

- a. Using its purchased practice aids, which prescribe the form, content, and frequency of independence representations that are to be obtained.
- b. Requiring that such representations be documented.

## Personnel Management

4.10. The objective of the *Personnel Management* element of a system of quality control is to provide the firm with reasonable assurance that all personnel have the proficiency to perform their assigned responsibilities. Attributes or qualities that enhance the proficiency of personnel who perform, supervise, or review work include integrity, objectivity, intelligence, judgment, competence, experience, and motivation.

4.11. AnyCity CPAs satisfies this objective by establishing and maintaining the following policies and procedures.

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<sup>1</sup>AICPA's *Professional Standards*, vol. 2, ET sec. 101.04, discusses circumstances when activities of a former practitioner could affect the firm's independence.

#### 4.12. Policy 1

**Personnel who are hired will possess the appropriate characteristics to enable them to perform competently.**

4.13. AnyCity CPAs implements this policy by—

- a. Establishing a general understanding among the partners of the attributes, achievements, and experiences desired in entry-level and experienced personnel.
- b. Establishing criteria to evaluate personal characteristics such as integrity, competence, and motivation.
- c. Setting guidelines as to additional procedures that are necessary when hiring experienced personnel such as performing background checks and inquiring about any outstanding regulatory actions.
- d. Designating a qualified individual in the firm to be responsible for managing the human resource function.

#### 4.14. Policy 2

**The firm will make personnel assignments based on the degree of technical training and proficiency required in the circumstances and the nature and extent of supervision to be provided.**

4.15. AnyCity CPAs implements this policy by conducting periodic partner and manager meetings to discuss the assignment of personnel to engagements. The factors to be considered in making such decisions include—

- Engagement size and complexity.
- Specialized experience and expertise required.
- Personnel availability and involvement of supervisory personnel.
- Timing of the work to be performed.
- Continuity and rotation of personnel.
- Opportunities for on-the-job training.
- Situations where independence or objectivity concerns exist.

#### 4.16. Policy 3

**Personnel will participate in general and industry-specific continuing professional education and professional development activities that enable them to satisfy responsibilities assigned and fulfill applicable continuing professional education requirements of the AICPA and regulatory agencies.**

#### 4.17. AnyCity CPAs implements this policy by—

- a. Assigning responsibility to a partner to maintain an office professional development program that—
  - (1) Provides that personnel in the office participate in professional development programs in accordance with firm guidelines and in subjects that are relevant to their responsibilities.
  - (2) Considers requirements of the AICPA, state boards of accountancy, and regulatory agencies in establishing the firm's CPE requirements.
- b. Encouraging participation in other professional development activities for personnel at each level within the firm, such as participation in external professional development programs, including graduate-level and self-study courses, membership in professional organizations, serving on professional committees, and writing for professional publications.
- c. Communicating and distributing to personnel, when applicable, changes in accounting, auditing, and independence requirements and the firm's guidance with respect to them.

#### 4.18. Policy 4

**Personnel selected for advancement will have the qualifications necessary to fulfill the responsibilities they will be called on to assume.**

#### 4.19. AnyCity CPAs implements this policy by—

- a. Assigning responsibility to a partner for making advancement and termination decisions. Such responsibilities include—
  - Identifying responsibilities and requirements for evaluation at each level and indicating who will prepare evaluations and when they will be prepared.

- Using forms for evaluating the performance of personnel.
  - Reviewing evaluations with the individual being evaluated on a timely basis.
- b. Counseling personnel regarding their progress and career opportunities by—
- (1) Annually summarizing and reviewing with personnel the evaluation of their performance, including an assessment of their progress with the firm. Considerations should include performance, future objectives of the firm and the individual, assignment preferences, and career opportunities.
  - (2) Periodically evaluating partners by means of counseling, peer evaluation, or self-appraisal, as appropriate.

## Acceptance and Continuance of Clients and Engagements

4.20. The objective of the *Acceptance and Continuance of Clients and Engagements* element of a system of quality control is to establish criteria for deciding whether to accept or continue a client relationship and whether to perform a specific engagement for that client. Such policies and procedures should provide the firm with reasonable assurance that (a) the likelihood of association with a client whose management lacks integrity is minimized, (b) the firm undertakes only those engagements that can be completed with professional competence, (c) the risks associated with providing professional services in particular circumstances are appropriately considered, and (d) an understanding with the client regarding the services to be performed is reached.

4.21. AnyCity CPAs satisfies this objective, both with respect to the initial period for which the firm is performing its service and for subsequent periods, by establishing and maintaining the following policies and procedures.

### 4.22. Policy 1

**The firm will evaluate factors that have a bearing on management's integrity.**

4.23. AnyCity CPAs implements this policy by—

- a. Informing personnel of the firm's policies and procedures, including those outlined in the firm's purchased practice aids, for accepting and continuing clients.
- b. Obtaining and evaluating available financial information regarding the client and its operations such as annual reports, interim financial statements, reports to regulatory agencies, income tax returns, and credit reports before accepting or continuing a client.
- c. Making inquiries of the client management about the nature and purpose of services to be provided.
- d. Making inquiries of the client's bankers, factors, attorneys, credit services, and others having business relationships with the entity.
- e. Communicating with the predecessor accountant when required or suggested by professional standards.
- f. Evaluating the information obtained regarding management's integrity.

#### 4.24. Policy 2

**The firm will evaluate whether the engagement can be completed with professional competence and accordingly undertake only those engagements that can be completed with professional competence and appropriately consider the risk associated with providing professional services in particular circumstances.**

#### 4.25. AnyCity CPAs implements this policy by—

- a. Evaluating whether the firm has obtained or can reasonably expect to obtain the knowledge and expertise necessary to enable it to perform the engagement.
- b. Specifying conditions that require evaluation of a specific client or engagement, obtaining relevant information to determine whether the relationship should be continued, and establishing a time period for evaluations to be made (for example, continuance decisions should be made at least annually). Conditions include the following:
  - Significant changes in the client, for example, a major change in senior client personnel, ownership, advisors, the nature of its business, or the financial stability of the client.
  - Changes in the nature or scope of the engagement, including requests for additional services.
  - Changes in the composition of the firm, for example, the inability to replace the loss of key personnel who are particularly



knowledgeable about a specialized industry, or the decision to discontinue services to clients in a particular industry.

- The existence of conditions that would have caused the firm to reject the client or engagement had such conditions existed at the time of the initial acceptance.
  - Client delinquent in paying fees. (This may also affect the firm's independence.)
  - Engagements for entities operating in highly specialized or regulated industries, including financial institutions, governmental entities, and engagements for employee benefit plans.
  - Where there is a burdensome amount of hours required to complete the engagement.
  - Engagements for entities in the development stage.
- c. Evaluating the information obtained regarding acceptance or continuance of the client or engagement.
- (1) All information obtained about the client or the specific engagement is evaluated by the engagement partner, who makes a recommendation regarding whether the client or engagement is to be accepted or continued.
  - (2) The engagement partner completes a client acceptance form and submits it to the managing partner for approval.
  - (3) The engagement partner signs a step in the planning program noting client continuance, and a form documenting client continuance is completed if conditions identified above (paragraph 4.25b) exist.
  - (4) The managing partner is responsible for evaluating and approving the recommendation made by the engagement partner. If the managing partner recommends not accepting or discontinuing a client relationship, all partners in the firm will review all of the information and participate in the acceptance or continuance decision.

#### 4.26. Policy 3

<p style="text-align: center;"><b>The firm will obtain an understanding with the client regarding the services to be performed.</b></p>
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4.27. AnyCity CPAs implements this policy by requiring that all understandings with the client be in writing by obtaining an engagement letter on all engagements, thus minimizing the risk of

misunderstanding regarding the nature, scope, and limitations of the services to be performed.

## Engagement Performance

4.28. The objective of the *Engagement Performance* element of a system of quality control is to provide the firm with reasonable assurance that the work performed by engagement personnel meets the applicable professional standards, regulatory requirements, and the firm's standards of quality. Policies and procedures for engagement performance encompass all phases of the design and execution of the engagement. To the extent appropriate and as required by applicable professional standards, these policies and procedures should cover planning, performing, supervising, reviewing, documenting, and communicating the results of each engagement. Policies and procedures should also provide that personnel refer to authoritative literature or other sources and consult, on a timely basis, with individuals within or outside the firm, when appropriate.

4.29. AnyCity CPAs satisfies this objective by establishing and maintaining the following policies and procedures.

### 4.30. Policy 1

**Planning for engagements will meet professional, regulatory, and the firm's requirements.**

4.31. AnyCity CPAs implements this policy by maintaining and providing personnel with the firm's purchased practice aids which prescribe the factors to be considered in the planning process by the engagement team and the extent of documentation of the considerations which may vary depending on the size and complexity of the engagement. Planning considerations include—

- Assigning responsibilities to appropriate personnel during the planning phase.
- Developing or updating background information.
- Developing a planning document that includes—
  - Proposed work programs, tailored to the specific engagement.
  - Staffing requirements and the need for specialized knowledge.

- Considering the economic conditions affecting the client or its industry and their potential impacts on the conduct of the engagement.
- Considering the risks and how they may affect the procedures to be performed.
- Preparing a budget that allocates a sufficient amount of time so the engagement will be performed in accordance with professional standards and the firm's quality control policies and procedures.

#### 4.32. Policy 2

**The engagement will be performed, supervised, reviewed, documented, and communicated in accordance with the requirements of professional standards, regulatory authorities, and the firm.**

#### 4.33. AnyCity CPAs implements this policy by—

- a. Providing adequate supervision during the course of an engagement. This supervision is based on the training, ability, and experience of the personnel assigned.
- b. Adhering to the guidelines set forth by the firm and in its purchased practice aids for the form and content of working papers.
- c. Utilizing appropriately tailored forms, checklists, and questionnaires to assist in the performance of the specific engagement.
- d. Adhering to documentation guidelines set by the firm regarding the review of working papers, financial statements, and reports:
  - (1) All reviewers are to have appropriate experience, competence, and responsibility.
  - (2) All work performed and the reports and financial statements issued are to be complete and comply with professional standards and firm policy.
  - (3) All engagements require appropriate evidence of review of working papers, financial statements, and reports.
  - (4) All differences of professional judgment within an engagement team are to be resolved by the engagement and the managing partner. The resolution of the differences must be appropriately documented. If a member of the team continues to disagree with the resolution, he or she may disassociate himself

or herself from the resolution of the matter and will be offered the opportunity to document that a disagreement still exists.

#### 4.34. Policy 3

**The firm will identify areas and specialized situations where consultation is required and will require personnel to refer to authoritative literature and practice aids and to consult, on a timely basis, with individuals within or outside the firm when appropriate (for example, when dealing with complex, unusual, or unfamiliar issues).**

4.35. AnyCity CPAs implements this policy by—

- a. Informing personnel of the firm's consultation policies and procedures.
- b. Consulting with appropriate individuals within and outside the firm when issues arise in certain areas.
- c. Requiring consultation in specialized areas or specialized situations, which may include—
  - Application of newly issued technical pronouncements.
  - Industries with special accounting, auditing, or reporting requirements, including unusually complex employee benefit plans.
  - Emerging practice problems.
  - Choices among alternative generally accepted accounting principles upon initial adoption or when an accounting change is made.
  - Reissuance of a report, consideration of omitted procedures after a report has been issued or subsequent discovery of facts that existed at the time a report was issued.
  - Filing requirements of regulatory agencies.
- d. Maintaining an adequate and up-to-date reference library that is accessible to all professional personnel and that includes materials related to clients served.
- e. Documenting all relevant facts, circumstances, professional literature used, and conclusions reached in the engagement working papers.
- f. Documenting the resolution of differences of opinion. If on some occasions there is an unresolved disagreement, an outside source may be consulted to assist in determining the appropriate application of accounting principles.

## Monitoring

4.36. The objective of the *Monitoring* element of a system of quality control is to provide the firm with reasonable assurance that the policies and procedures relating to the other elements of quality control are suitably designed and being effectively applied. Monitoring is an ongoing consideration and evaluation process.

4.37. AnyCity CPAs satisfies this objective by establishing and maintaining the following policies and procedures.

### 4.38. Policy 1

**The firm will consider and evaluate, on an ongoing basis, the relevance and adequacy of its quality control policies and procedures.**

4.39. AnyCity CPAs implements this policy by designating a partner or a management-level individual with appropriate authority to be responsible for quality assurance, including—

- Assuring that the firm's quality control policies and procedures and its audit methodology remain relevant and adequate. Factors to be considered include—
  - Mergers and divestitures of portions of the practice.
  - Changes in professional standards or other regulatory requirements applicable to the firm's practice.
  - Results of annual inspections and peer reviews.
  - Review of litigation and regulatory enforcement actions against the firm and others.
  - Impact that changes in technology may have on clients' methods of doing business.
  - Changes in clients' industries that impact their operations.
  - Changes in applicable AICPA membership requirements.
- Determining whether personnel have been appropriately informed of their responsibilities for maintaining the firm's standards of quality in performing their duties.
- Identifying the need to—
  - a. Revise policies and procedures related to the other elements of quality control because they are ineffective or inappropriately designed.



4 without performing an inspection of individual engagements. Scenario II illustrates how AnyCity CPAs implements Policy 4 through the use of engagement inspection.

4.46. In determining which scenario is appropriate, consideration should be given to SQCS No. 3, *Monitoring a CPA Firm's Accounting and Auditing Practice*, paragraphs 3–7, which sets forth guidance that should be consulted in determining the extent of inspection procedures to be performed, including those related to individual engagements. Also, consideration should be given to time pressures such as report due dates and time budgets when considering whether a firm can effectively monitor its compliance with its policies and procedures through preissuance or postissuance engagement reviews.

## Scenario I

4.47. AnyCity CPAs implements Policy 4 by—

- a. Designating a partner or management-level individual not previously associated with the engagement to perform a preissuance review of the engagement or a postissuance review of the engagement shortly after the release of the report. Deficiencies identified as a result of this process will be continuously summarized and evaluated to determine whether—
  - (1) Additional emphasis should be placed on the specific areas or industries in future engagements.
  - (2) Existing policies and procedures should be modified so any deficiencies noted do not recur.
- b. Reviewing correspondence regarding consultation on independence, integrity, and objectivity matters, and acceptance and continuance decisions.
- c. Reviewing the resolution of matters reported by professional personnel on independence circularization forms to determine that matters have been appropriately considered and resolved.
- d. Summarizing the deficiencies noted resulting from the preissuance and postissuance reviews.
- e. Preparing a summary of the deficiencies noted for the partner or management group in order to set forth any recommended changes to the firm's policies and procedures.
- f. Communicating the deficiencies noted and the agreed-upon quality control changes to all professional personnel.

## Scenario II

4.48. AnyCity CPAs implements Policy 4 by—

- a.* Designating a partner to be responsible for performing an annual inspection using guidance prepared by the AICPA for performing inspection procedures. These procedures include reviewing a cross-section of engagements using the following criteria:
  - (1) Significant specialized industries with emphasis given to high-risk engagements
  - (2) Engagements for employee benefits
  - (3) First-year engagements
  - (4) Level of service performed (that is, audit, review, compilation, and attest)
  - (5) All partners and other management level personnel having accounting and auditing responsibilities
- b.* Reviewing correspondence regarding consultation on independence, integrity, and objectivity matters, and acceptance and continuance decisions.
- c.* Reviewing the resolution of matters reported by professional personnel on independence circularization forms to determine that matters have been appropriately considered and resolved.
- d.* Summarizing findings resulting from the inspection procedures.
- e.* Preparing a summary inspection report for the partner or management group that evaluates the overall results of the inspection and that sets forth any recommended changes to the firm's policies and procedures.
- f.* Communicating inspection findings and agreed-upon quality control changes to all professional personnel.



## **Chapter 5**

# **Jane Brown, CPA's System of Quality Control for Her Accounting Practice**

5.01. This chapter describes how Jane Brown, CPA implements each element of quality control for her accounting practice. Jane Brown, CPA is a hypothetical firm that is presumed to be a sole owner without any professional staff who occasionally hires per diem professionals. Her accounting practice consists only of engagements subject to the Statements on Standards for Accounting and Review Services. She uses purchased practice aids that have been subjected to peer review in accordance with standards established by the AICPA. Jane Brown, CPA recognizes that her policies and procedures will have to be changed if she hires full-time or part-time professional staff.

## **Independence, Integrity, and Objectivity**

5.02. The objective of the *Independence, Integrity, and Objectivity* element of a system of quality control is to provide the firm with reasonable assurance that personnel maintain independence (in fact and in appearance), in all required circumstances, perform all professional responsibilities with integrity, and maintain objectivity in discharging professional responsibilities.

5.03. Jane Brown, CPA satisfies this objective by establishing and maintaining the following policy and procedures.

#### 5.04. Policy 1

**I will adhere to applicable independence, integrity, and objectivity requirements. These requirements include regulations, interpretations, and rulings of the AICPA, state CPA societies, state boards of accountancy, state statutes, and other regulatory agencies where applicable.**

5.05. Jane Brown, CPA implements this policy by—

- a. Purchasing AICPA *Professional Standards* annually.
- b. Reviewing unpaid fees from clients to ascertain whether any outstanding amounts impair the firm's independence.
- c. Reviewing relevant pronouncements relating to independence, integrity, and objectivity in the *Journal of Accountancy* and retaining copies of them.
- d. Signing a step on each engagement program attesting to her independence and requiring per diem personnel to do the same.
- e. Complying with *Statements on Standards for Accounting and Review Services* with respect to disclosing instances where the firm is not independent in the accountant's compilation report.

## Personnel Management

5.06. The objective of the *Personnel Management* element of a system of quality control is to provide the firm with reasonable assurance that all personnel have the proficiency to perform their assigned responsibilities. Attributes or qualities that enhance the proficiency of personnel who perform, supervise, or review work include integrity, objectivity, intelligence, judgment, competence, experience, and motivation.

5.07. Jane Brown, CPA satisfies this objective by establishing and maintaining the following policies and procedures.

#### 5.08. Policy 1

**I will maintain the degree of technical training and proficiency required in the circumstances.**

5.09. Jane Brown, CPA implements this policy by—

- a. Evaluating the knowledge and expertise required to perform the engagement prior to accepting the client or engagement.
- b. Accepting only those engagements that can be performed with professional competence.

#### 5.10. Policy 2

**I will participate in general and industry-specific continuing professional education and professional development activities that enable me to satisfy my responsibilities and fulfill applicable continuing professional education requirements of the AICPA and regulatory agencies.**

5.11. Jane Brown, CPA implements this policy by—

- a. Developing a professional development program and considering the requirements of the AICPA and state boards of accountancy.
- b. Participating in external professional development programs, including graduate-level and self-study courses.
- c. Joining and becoming an active member of professional organizations.
- d. Serving on professional committees, writing for professional publications, when appropriate, and participating in other professional activities.
- e. Considering changes in the applicable professional standards when determining her professional development program.

## **Acceptance and Continuance of Clients and Engagements**

5.12. The objective of the *Acceptance and Continuance of Clients and Engagements* element of a system of quality control is to establish criteria for deciding whether to accept or continue a client relationship and whether to perform a specific engagement for that client. Such policies and procedures should provide the firm with reasonable assurance that (a) the likelihood of association with a client whose management lacks integrity is minimized, (b) the firm undertakes only those engagements that can be completed with professional competence, (c) the risks associated with providing professional services in particular circum-

stances are appropriately considered, and (d) an understanding with the client regarding the services to be performed is reached.

5.13. Jane Brown, CPA satisfies this objective, both with respect to the initial period for which the firm is performing its service and for subsequent periods, by establishing and maintaining the following policies and procedures.

#### 5.14. Policy 1

**I will evaluate factors that have a bearing on management's integrity.**

5.15. Jane Brown, CPA implements this policy by—

- a. Obtaining information such as the following before accepting or continuing a client:
  - Available information regarding the client and its operations from sources such as prior-year reports, internally generated financial statements (if applicable), income tax returns, and credit reports.
  - The nature and purpose of the services to be provided.
- b. Inquiring of third parties such as bankers, factors, legal counsel.
- c. Communicating with the predecessor accountant when required or suggested by professional standards.
- d. Evaluating the information obtained regarding management's integrity.

#### 5.16. Policy 2

**I will evaluate whether the engagement can be completed with professional competence and accordingly undertake only those engagements that can be completed with professional competence and appropriately consider the risk associated with providing professional services in particular circumstances.**

5.17. Jane Brown, CPA implements this policy by—

- a. Considering conditions that require evaluation of a client or specific engagement and obtaining the relevant information to determine whether the relationship should be continued. Conditions include—
  - Establishing a time period for evaluations to be made (before the current-year engagement work begins).

- Significant changes in the client, for example, a major change in ownership, senior client personnel, directors, advisors, the nature of the business, or the financial stability of the client.
  - Changes in the nature or scope of the engagement, including requests for additional services.
  - The existence of conditions that would have caused the firm to reject the client or engagement had such conditions existed at the time of the initial acceptance.
  - Client delinquent in paying fees. (This may also affect the firm's independence.)
- b. Determining if the knowledge and expertise necessary to perform the engagement exists or can reasonably be obtained.
  - c. Evaluating the information obtained regarding the engagement and making the acceptance decision and documenting her evaluation or conclusion in a memorandum.
  - d. Evaluating the information obtained regarding the engagement and making the continuance decision.

#### 5.18. Policy 3

**I will obtain an understanding with the client regarding services to be performed.**

5.19. Jane Brown, CPA implements this policy by—

- a. Adhering to all requirements set forth in professional standards regarding obtaining an understanding with the client.
- b. Requiring that the understanding with the client be documented either through an engagement letter or in a memorandum.

## Engagement Performance

5.20. The objective of the *Engagement Performance* element of a system of quality control is to provide the firm with reasonable assurance that the work performed by engagement personnel meets the applicable professional standards, regulatory requirements, and the firm's standards of quality. Policies and procedures for engagement performance encompass all phases of the design and execution of the engagement. To the extent appropriate and as required by applica-

ble professional standards, these policies and procedures should cover planning, performing, supervising, reviewing, documenting, and communicating the results of each engagement. Policies and procedures should also provide that personnel refer to authoritative literature or other sources and consult, on a timely basis, with individuals within or outside the firm, when appropriate (for example, when dealing with complex, unusual, or unfamiliar issues).

5.21. Jane Brown, CPA satisfies this objective by establishing and maintaining the following policies and procedures.

**5.22. Policy 1**

**I will plan engagements to meet professional  
and the firm's requirements.**

5.23. Jane Brown, CPA implements this policy by adhering to professional standards regarding the planning process and the extent of documentation, if applicable. Engagement planning considerations may include, when applicable—

- Developing or updating background information.
- Obtaining an engagement letter.
- Reviewing prior financial statements and accountant's report.
- Using work programs.

**5.24. Policy 2**

**I will perform, supervise, review, document, and  
communicate in accordance with the requirements of  
professional standards and the firm.**

5.25. Jane Brown, CPA implements this policy by requiring the use of purchased practice aids on all appropriate engagements including—

- Maintaining availability of purchased practice aids and AICPA professional standards.
- Preparing all working papers and checklists in accordance with firm policy in order to document work performed in accordance with professional standards.
- Reviewing and initialing all engagement working papers in situations where per diem staff are utilized.

### 5.26. Policy 3

**I will identify areas and specialized situations where consultation is required and I will require personnel to refer to authoritative literature and practice aids and will consult, on a timely basis, with individuals outside the firm when appropriate (for example, when dealing with complex, unusual, or unfamiliar issues).**

5.27. Jane Brown, CPA implements this policy by—

- a. Maintaining a technical reference library to assist in resolving practice problems. The library is updated as needed.
- b. Referring to the AICPA's Technical Hotline when a practice problem arises for which the firm needs additional expertise.
- c. Requiring that documentation of consultation include all relevant facts and circumstances and references to professional literature used in the determination and conclusion reached. This documentation is to be retained in the engagement working papers.

## Monitoring

5.28. The objective of the *Monitoring* element of a system of quality control is to provide the firm with reasonable assurance that the procedures relating to the other elements of quality control are suitably designed and being effectively applied. Monitoring is an ongoing consideration and evaluation process.

5.29. Jane Brown, CPA satisfies this objective by establishing and maintaining the following policies and procedures.

### 5.30. Policy 1

**I will consider and evaluate, on an ongoing basis, the relevance and adequacy of my quality control policies and procedures.**

5.31. Jane Brown, CPA implements this policy by reviewing procedures that identify the need to—

- a. Revise policies and procedures that are ineffective due to changes in professional standards or the nature of the practice.

- b.* Improve compliance with firm policies and procedures that are related to the other elements of quality control.

#### **5.32. Policy 2**

**I will consider and evaluate, on an ongoing basis, the appropriateness of my guidance materials and any practice aids.**

5.33. Jane Brown, CPA implements this policy by reviewing and determining that the firm's purchased practice aids are up-to-date based on the issuance of new professional pronouncements.

#### **5.34. Policy 3**

**I will consider and evaluate, on an ongoing basis, the effectiveness of professional development activities.**

5.35. Jane Brown, CPA implements this policy by—

- a.* Reviewing CPE records to determine whether the programs (AICPA or state society classroom training and self-study programs) are appropriate for the firm's practice.
- b.* Reviewing CPE records to determine compliance with the requirements of the AICPA and other regulatory bodies.

#### **5.36. Policy 4**

**I will consider and evaluate, on an ongoing basis, compliance with my policies and procedures.**

5.37. Jane Brown, CPA implements this policy by performing a post-issuance review of selected engagements, in order to—

- a.* Summarize findings resulting from such reviews.
- b.* Place additional emphasis on certain deficient areas in future engagements.
- c.* Determine if existing policies and procedures should be modified so any deficiencies noted do not recur.



# Glossary of Selected Terms

**Accounting and auditing practice.** All audit, attest, accounting and review, and other services for which standards have been established by the AICPA Auditing Standards Board or the AICPA Accounting and Review Services Committee under rule 201 or 202 of the AICPA Code of Professional Conduct (AICPA, *Professional Standards*, vol. 2, ET secs. 201 and 202). Standards may be also established by other AICPA technical committees; engagements that are performed in accordance with those standards are not encompassed in the definition of an accounting and auditing practice.

**Firm.** Defined in the AICPA Code of Professional Conduct as “a form of organization permitted by state law or regulation whose characteristics conform to resolutions of Council that is engaged in the practice of public accounting, including the individual owners thereof” (AICPA, *Professional Standards*, vol. 2, ET sec. 92.05).

**Personnel.** All individuals who perform professional services for which the firm is responsible, whether or not they are CPAs.

**Policy.** A definite course or method of action to guide and determine present and future decisions. It is a guide to decision making under a given set of circumstances within the framework of a firm’s objectives, goals, and management philosophies.

**Procedure.** A particular way of accomplishing something, an established way of doing things, a series of steps followed in a definite regular order. It provides for the consistent and repetitive approach to actions.

